

UT 96-9

Tax Type: USE TAX

Issue: Use Tax on Purchases, Fixed Assets, or Consumables
Machinery & Equipment Exemption - Manufacturing

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
ADMINISTRATIVE HEARINGS DIVISION
CHICAGO, ILLINOIS

THE DEPARTMENT OF REVENUE)	
OF THE STATE OF ILLINOIS,)	
Petitioner)	No.
)	
v.)	IBT No.
)	
TAXPAYER,)	
Taxpayer)	Linda K. Cliffler,
)	Admin. Law Judge
)	

RECOMMENDATION FOR DISPOSITION

APPEARANCES: Richard E. Peterson of Kirkland & Ellis for TAXPAYER; Alan Osheff, Special Assistant Attorney General for the Illinois Department of Revenue.

SYNOPSIS:

TAXPAYER (hereinafter "TAXPAYER" or "Taxpayer") was issued a Notice of Tax Liability ("NTL") XXXXX on December 30, 1994. Although the NTL is based on several issues, the taxpayer is only contesting the imposition of use tax on the purchase of a computer system which was leased to CORPORATION. CORPORATION represented to the taxpayer that the computer system was to be used in its manufacturing process, and provided taxpayer with a blanket exemption statement.

The issue herein is what documentation is necessary for a lessor to support its eligibility for the manufacturing machinery and equipment exemption of the Illinois Use Tax Act.

On consideration of this matter it is my recommendation that this matter be resolved in favor of the Department.

FINDINGS OF FACT:

1. TAXPAYER ("TAXPAYER") leased computer equipment to CORPORATION in 1991. (Tr. p. 20)
2. TAXPAYER claimed the manufacturing and machinery exemption on its purchase of the computer equipment which was to be leased by CORPORATION. (Tr. pp. 13, 20, 22)
3. CORPORATION provided TAXPAYER with a blanket exemption certificate.¹ (Tr. pp. 12-23, Taxpayer Ex. No. 1)
4. No documentation regarding the use of the equipment was given to the auditor. (Tr. p. 32)

CONCLUSIONS OF LAW:

According to Illinois law, a lessor is subject to Use Tax on the purchase of property which is subsequently leased to third parties. The lessor is considered to be the user of the property and thus subject to the Use Tax when purchasing tangible personal property which is leased to others. 86 Admin. Code ch. I, Sec. 150.305(e); Telco Leasing, Inc. v. Allphin, 63 Ill.2d 305 (1976).

Sales of machinery and equipment used primarily in the manufacturing or assembling of tangible personal property for sale or lease may be exempt from Use Tax. 35 ILCS 105/3-5(18).² Pursuant to 35 ILCS 105/3-50, the manufacturing machinery and equipment exemption "includes the sale of exempted types of machinery or equipment to a purchaser who is not the manufacturer, but who rents or leases the use of the property to a manufacturer." Thus, a lessor may be entitled to the manufacturing machinery and equipment exemption even though it is not the party putting the equipment to its exempt use.

The only issue to be decided in this case is whether the taxpayer, the lessor, has sufficiently substantiated the exempt use to qualify for the exemption. Departmental regulations under Retailers' Occupation Tax ("ROT")

¹ The Exemption Certificate admitted as Taxpayer Ex. No. 1 was dated January 1, 1990 and was missing the second page which gave the registration numbers for the taxpayer's various locations. Taxpayer Ex. No. 2 was a later Exemption Certificate dated January 1, 1994 which included the second page.

² Formerly Ill. Rev. Stat. 1991, ch. 120, ¶439.3-5(18).

apply to the Use Tax where they are not in conflict. 86 Admin. Code ch. I, Sec. 150.1201. The taxpayer has cited 86 Admin. Code ch. I, Sec. 130.330(g)(1), relating to ROT, which states that generally a taxpayer must either prepare a certificate of exemption for each transaction which states the facts establishing the exemption, or where the user has an active registration or resale number, that number may be given. These regulations, however, relate to the retailer and the records he must retain to show that a sale is an exempt sale from ROT, not what is required of the user. Regulation Section 130.330(g)(3) makes it clear that subsection g(1) applies to the retailer's duty:

A vendor who makes sales of machinery or equipment to a manufacturer or lessor of a manufacturer must collect Use Tax, and will owe Retailers' Occupation Tax, on that sale unless the purchaser certifies the exempt nature of the purchase to the vendor as set out above.

We are not dealing here with an asserted liability of ROT against the retailer, but rather a Use Tax liability imposed on the purchaser. In this case the "user" is the lessor who does not actually employ the equipment in an exempt manner itself. Since it is the lessor who is claiming the exemption, however, it is the lessor who must have sufficient records to support the exemption. The lessor stands in the shoes of the lessee as far as being able to claim the manufacturing machinery and equipment exemption, and it is the lessor who bears the burden of being able to prove the exempt use. A blanket resale exemption certificate³ does not specify the use to which the machinery is put, and in the absence of other records is not sufficient to support the exemption.⁴

It is important to note that the Department has no jurisdiction over the lessee. The lessee has no liability for either ROT or Use Tax on a lease, so

³ The exemption certificate provided by CORPORATION states "all tangible personal property...will be purchased for (a) resale, (b) physical incorporation as an ingredient or constituent into the product of CORPORATION, or (c) for use in the manufacture of the product of CORPORATION, unless otherwise stated on CORPORATION Purchase Order.

⁴ The auditor testified that had the taxpayer been able to produce an affidavit from the lessee stating how the equipment was being used, and that use was exempt, he would not have imposed the use tax. (Tr. p. 32)

the Department cannot audit the lessee's records to determine whether the use is exempt. The only way the Department can acquire information as to whether leased machinery qualifies for the manufacturing machinery and equipment exemption, therefore, is from the lessor. Furthermore, the lessor has within its means the ability to require the lessee to provide it with certification relating to the equipment's use as a part of the contractual process of leasing equipment.

While a resale certificate is sufficient on its face to insulate the retailer from liability, it does not protect the user. There are strong policy reasons for protecting the retailer. If a retailer was required to inquire into the facts behind every sale for resale, commerce would grind to a halt. Even though the acceptance in good faith of a resale certificate may protect the retailer from liability, it does not bar the Department from proceeding against the purchaser. If the purchaser has represented that an item is being purchased for resale, but the Department determines that it was purchased for another purpose, the Department may collect use tax from the purchaser.

Likewise, while the certificate of exemption here would be sufficient to protect the seller of the equipment from liability, it is not sufficient to protect the user (the lessor) from liability if the machinery is not being used for an exempt purpose. Section 130.330(f)(2) of the regulations provides that in the situation where the lessee is no longer using the property in an exempt manner, the lessor will be subject to the tax.

Ultimately, the taxpayer here bears the burden of proving that the machinery on which the exemption is claimed is used in an exempt manner. Taxpayer has not produced any evidence regarding the use of the machinery and thus, has failed to meet its burden.

WHEREFORE, for the reasons stated above, it is my recommendation that the Notice of Deficiency be finalized in its entirety.

Date: _____

Linda K. Cliffel
Administrative Law Judge